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PREPARATORY COMMISSION FOR THE
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STATEMENT TO THE PLENARY BY THE CHAIRMAN OF SPECIAL COMMISSION 2 ON THE PROGRESS OF WORK IN THAT COMMISSION

1. Special Commission 2 held seven meetings at the current session. Two of its scheduled meetings were given over to the first meeting of the Training Panel to enable it to commence its work on the Training Programme. The programme of work for the session was contained in paragraph 35 of LOS/PCN/L.90. As a result of the limited number of meetings, the Special Commission was only able to consider the first item on its programme of work, namely operational options with special reference to the joint venture option as contained in document LOS/PCN/SCN.2/WP.18 and Add.1. The Chairman's Advisory Group on Assumptions met twice during the session, and consultations between the Coordinator of the Contact Group of the Group of 77 on Special Commission 2 Matters and the Coordinator for the Group of Six continued with regard to recommending a single option for the status and structure of the institutional arrangement during the transitional period as contained in the Chairman's paper, LOS/PCN/SCN.2/1990/CRP.5 and Add.2.

Operational options with reference to the joint venture option as contained in document LOS/PCN/SCN.2/WP.18 and Add.1

2. The Special Commission recalled that at its 105th meeting the Special Representative of the Secretary-General for the Law of the Sea had introduced the working papers under reference, pointing out that joint venture arrangements as a method of operation for the Enterprise had been the subject of consideration by the Preparatory Commission at various times since 1983.

3. It was pointed out that in 1971, when the Latin American Group introduced its 13-power draft to deal with the international seabed area, the joint venture option was felt to be the only option for exploration, exploitation

and processing. There seems to be at the current stage general acceptance of the joint venture option as the preferred option for the Enterprise in its initial operations. It is the accepted view that the joint venture option offers clear advantages with respect to the transfer of technology, training of personnel, finance, and processing and marketing.

4. In conducting its work, the Special Commission decided to undertake a section-by-section reading of the two documents, which has helped to focus attention on the joint venture option without detracting from other operational options. It decided further to provide annotations, as appropriate, both to the sections contained in LOS/PCN/SCN.2/WP.18 and to the explanatory memorandum.

5. With regard to the explanatory memorandum in the working paper, the view was expressed that a decision with respect to the joint venture option would depend on how the following points were addressed:

(i) The form the joint venture would take, that is, contractual or incorporated;

(ii) The ratio of capital participation of the joint venture partners. In the case of the Enterprise, it was noted that this would depend on the rate of contributions of countries that had ratified the Convention;

(iii) The need to ensure that the decision-making mechanism within the joint venture recognized the Enterprise's right to have a say in its affairs;

(iv) Transfer of technology (section 8 of the working paper);

(v) Training (section 9);

(vi) The manner in which conflicts would be resolved between the partners (section 21).

6. With regard to the type of joint venture arrangement used as a model in the working paper, i.e., the incorporated rather than the contractual, questions were raised as to why the former model had been chosen when the explanatory memorandum had indicated the advantages of the contractual joint venture. It was noted that the basic intentions of the two parties would be reflected in the provisions of either the contractual or the incorporated joint venture and that the difference would be in the modality of implementation.

7. It was suggested that on the very first page of the model contract, after each party, the words "represented by" should be added since it was usual practice to add a reference to the person who had signed the contract. It was also suggested that the definition of the Enterprise in the first preambular paragraph was restrictive when compared to the definition provided in

annex IV, article 1. It was stated that since the Enterprise not only operated in the Area but also carried out other functions, there was a need to elaborate on the scope of its activities.

8. With respect to section 1, Definitions, the view was expressed that if a definition had been given for the Authority then a definition should be given for the Enterprise. In this connection, it was suggested that the preambular paragraph referred to above should only state what the activity was, and that if a definition was included in section 1 it would need to conform to annex IV, article 1. Another view was that the Enterprise was a moral person of the contract and as a result did not need to be defined. The view was held that there might be a need to define the Participant. Finally, it was stated that it was usual practice to describe the contracting parties and not to define them. It appears, however, to be generally accepted that a definition is not necessary as long as the contracting parties are described within the contract.

9. The definition of applicable law in section 1 and provisions regarding it as contained in section 22 of the model contract resulted in considerable discussions. It was suggested that it would be necessary to de-link section 1.2 from section 22 so that applicable law could be defined as the law to be applied to the contract. It was also agreed to separate sections 22.1 and 22.2 since the former dealt with the applicable law which would govern the contract and the latter with enforcement of the law. Concern was expressed with section 22.2 and the inability of the Enterprise to enforce a decision against a partner who was not a Party to the Convention. It was noted that since there could not be a contract unless the entity, whether public of private, was sponsored by a Party to the Convention, the legal provisions in annex III, article 21 (1), must be built into the contract between the parties. It was also pointed out that it was necessary to distinguish between the substantive and the procedural laws of the country of the contract, and that the applicable substantive laws were those to be applied and implemented when decisions needed to be enforced.

10. With regard to section 2, Scope, it was held that there was a gap in section 2.2. This arose because the working paper addressed itself solely to the assets of the joint venture and did not consider the issue of intellectual property and the ownership of patents which were involved in the transfer of technology in such a high-technology joint venture. It was noted that an essential component of any high-technology joint venture was research and development, and if the Enterprise were to be competitive in the marketplace additional attention should be directed to the matter in the model contract.

11. With regard to section 2.4, it was pointed out that this did not constitute usual practice. Usually, the company was managed by the party which held at least 51 per cent of the shares of the company. Another view was that since the choice of the manager was dependent on the level of competence, sometimes the minor participant could be the manager. The view was expressed that the wording of section 2.4 might make the switch, for the Enterprise to become the manager mandatory. It was suggested further that the

provision be reworded to allow for this flexibility. It was also noted that the provision should provide for the possibility of a third party becoming the manager of the company.

12. Regarding section 3, Term, the view was held that its language could be made clearer. It was pointed out that in the French text the contract would be in effect from the date of its conclusion, while usual practice was to state that the contract would enter into force on the date of signature. It was suggested that the article needed to stipulate that the contract would be terminated in the event of unusual circumstances such as bankruptcy. Another view was that this concern was covered by the provisions of section 17 (c) which dealt with unusual circumstances.

13. In respect of section 4, Responsibilities of the Participant, it was suggested that the list of the Participant's responsibilities was not exhaustive and that the Participant needed to present reports on production and other activities, and to report to the Board of Directors. In this regard, it was noted that while in section 5 (e) provision was made for the Enterprise to cooperate with the Participant in carrying out the training programme there was no corresponding provision in section 4 obliging the Participant to train people for the Enterprise. Similarly, it was noted that while the obligation of the Participant to transfer technology was provided for in section 8, that obligation was not reflected in section 4.

14. Another view was that it was not necessary to add these obligations to section 4. A number of drafting proposals were made. It was suggested that section (a) be redrafted to read as follows:

> "Until the Enterprise assumes such responsibility the Participant shall carry out activities under this contract as manager of the Joint Venture Company in accordance with section 2.4",

and that section 4 (b) be redrafted as follows:

> "The Participant shall thereafter cooperate with the Enterprise so as to facilitate performance by the Enterprise of its responsibilities as the manager of the Joint Venture Company."

It was also suggested that a new section 4 (c) be added to read:

> "The Participant shall provide training for the Enterprise."

15. With respect to section 6, The Joint Venture Company, a number of views were expressed. With regard to section 6.1 the view was put forward that the term "headquarters" in different legal systems could be interpreted in a number of ways. It was suggested that the provision be amended to read "siège sociale" and headquarters. It was pointed out that in English commercial law the term "headquarters" was the principal place of business of the company. Regarding section 6.2, the view was expressed that it was necessary to elucidate all the details on the Articles of Association and the

Memorandum of the Joint Venture Company. The need to specify the currency in which the capital of the Joint Venture Company would be paid was indicated in section 6.3. It was pointed out that since the Joint Venture could be for exploration and/or exploitation and that while the capital input of the two parties might be the same in the beginning, it would be different once exploitation commenced, because the Enterprise's equity would be an explored site. It was also suggested that since WP.18 was only a model contract, this type of specificity was not required.

16. Misgivings were expressed in relation to section 6.6. The point was made that the provision could result in the party providing the loan, mortgaging the collective loan capital of the company and thus hampering its work. It was stated in this connection that since the loan would have to be secured, a mortgage problem would indeed arise.

17. Regarding section 6.7, it was suggested that it would be necessary to specify the minimum number of the members of the Board of Directors and the number that constituted a quorum. The point was made that the section needed to specify how a decision would be taken if the number of votes on either side of an issue were equal, and whether or not the chairman of the Board of Directors would have a casting vote.

18. Regarding section 6.9, it was stated that section 6.9 (b) was ambiguous and that either it should be deleted or it should specify what activities were prohibited. In relation to section 6.10, it was felt that the majority required for substantive issues should be more than a simple majority and that it should be left to the parties to decide on the actual percentages.

19. In the discussions on section 7, Ownership of property, the view was expressed that it was usual practice for the assets of the company to be divided according to the number of shares held by each party. Under this view, upon termination of the contract, debts would first be recovered and the remainder of the assets shared in proportion to the shareholding. Another view was that since the assets would have been fully recovered as development or operating costs, these assets became the property of the Enterprise.

20. With respect to section 8, Availability of technology, the view was expressed that upon termination of the contract the technology should be transferred to the Joint Venture Company.

21. Regarding section 9, Training, it was stated that if the word "staff" referred to the staff of the Enterprise, then the cost of training should not be borne by the Joint Venture Company. On the other hand, if it referred to staff of the Joint Venture Company, then the cost of training should be borne by the company. It was stated that training should not be an obligation and that these matters should be freely negotiated between the Enterprise and the Participant, as equal partners in the joint venture. The attention of the Special Commission was drawn to resolution II, paragraph 12 (a) (ii); article 144 (2) (b); and annex III, article 15, as provisions that made training by the Participant obligatory. It was pointed out that

paragraph 12 (a) (ii) of resolution II was applicable only in the preparatory phase and that when the Convention entered into force and effect it would no longer be applicable.

22. In relation to section 10, Procurement of goods and services, it was suggested that all tenders be internationally advertised, thus avoiding hidden solicitations and inducements by suppliers and contractors.

23. With respect to section 13, Reports, it was pointed out that the problem of ownership had not been properly addressed in the section. It was also pointed out that the question of management should be addressed in section 2, Scope.

24. It was suggested that in section 14, Examination and inspection, and in particular in 14.1, the following words should be added to the text: "... and in accordance with generally recognized accounting principles and procedures".

25. Regarding section 15, Assignment and transfer, the view was expressed that the commentary did not provide that the other party should have the preferential right to purchase the share which the party wished to give up. It was suggested that the provision in 15 (a) needed to be brought in line with section 15 (b) to the effect that no assignment or transfer could take place without the prior consent of the other party in writing. Another view was that the right of first refusal also meant the right of pre-emption, and that it was a preferential right or right of pre-emption. A proposal was made to redraft section 15 (b) to provide clarity. In the proposal, section 15 (b) is to read as follows:

> "[The Enterprise and the Participant shall each] have the right to sell, assign, transfer, convey or otherwise dispose of any of its equity shares in the Joint Venture Company to the other Party or to any third party with the prior consent of the other party, which consent shall not be unreasonably withheld."

26. With regard to section 16, Force majeure, following a debate as to whether to enumerate the conditions which constituted force majeure and whether to include the word "foresee" in section 16.1 before the word prevent, it was decided to maintain section 16.1 as is and return to the question on the second reading of the working paper. It was noted that the wording of the clause was one that was used internationally and might derive from International Chamber of Commerce publication No. 421.

27. The question of whether material breach as contained in section 17.1 (b) should be substituted for by fundamental breach in section 17, Termination, was deferred until the second reading of the working paper. Regarding the question of whether the contract could be terminated in case of force majeure, a proposal was made to add a new subsection (d) to section 17.1, to read as follows:

> "if an event of force majeure has occurred and has lasted uninterrupted for a period of ... months".

28. It was suggested that section 17.2 might need to be improved. It was noted that it provided for termination of the contract, but that under section 17.1 (c) termination was also available in the event of bankruptcy. It was pointed out that the intention of section 17.2 was that where the contract was terminated under section 17.1 it did not have the effect of cancelling those obligations of the parties that had already arisen. It was suggested that section 17.2 should have been written in the negative rather than the positive sense so that the effect of termination does not negate obligations. The observation was made that if a party to the joint venture became bankrupt the reason for its inability to honour its obligations would be bankruptcy and not the termination of the contract. It was proposed that section 17.2 be redrafted to read as follows:

> "Termination of this contract pursuant to this section shall not operate to discharge, terminate or extinguish rights and obligations which have already arisen under the terms of this contract."

29. It was also noted that since the model contract only applies to the relations between the Enterprise and the Participant, the provision in section 17.2 could not be applied to third parties. It was decided that this point would be reflected in an annotation to section 17.

30. With regard to section 18, Waiver, it was noted that the provision sought to preserve the right of the parties if it became necessary to do so. If a party sat on its right then this could not be interpreted as a waiver of its rights. The view was expressed that the provision in section 18.1 was too flexible in that the waiver seemed to be given in perpetuity.

31. The view was expressed that in section 20, Revision, 20.1 and 20.2 should be joined into a single paragraph. Another view was that the provision would become a little cumbersome if the two paragraphs were combined. An observation was made regarding the word inequitable in section 20.1. It was stated that the notion of inequitability was subjective, and that as subjective as it might be, either party might plead inequitability. The view was expressed that inequitability was not a sufficient reason to revise a contract and that a contract should not be revised only because one party had failed to advance in the way it had expected to. It was also suggested that the circumstances mentioned in section 20.1 would have to be extraordinary and unexpected circumstances in order to justify a renegotiation of the contract.

32. In relation to section 21, Disputes, it was suggested that before resort to arbitration it was necessary to resort to the procedures mentioned in Article 33 of the Charter of the United Nations, i.e., negotiation, enquiry, mediation and conciliation. It was requested that the text of section 21 be amended to include this point.

33. With respect to section 22, Applicable law, it was decided that it should be redrafted to reflect the usual practice. It was pointed out that the commentary in WP.18/Add.1 had indicated that section 22 had been based on annex III, article 21 (1). Annex III deals with a special kind of contract,

i.e., the contract between the Authority and the contractor. It was noted that in the working paper one was dealing with a joint venture contract between the Participant and the Enterprise. There would be two contracts, one between the Authority and the Enterprise for a plan of work and the second between the Enterprise and the entity which joined in a joint venture. Since article 21 (1) of annex III does not deal with the same subject-matter, it was felt that following that provision would straitjacket the Enterprise.

Transitional arrangements for the Enterprise

34. During the current session consultations were held between the Coordinator of the Contact Group of the Group of 77 on Special Commission 2 Matters and the Coordinator of the Group of Six with regard to recommending a single option for the status and structure of the institutional arrangement during the transitional period as contained in the Chairman's paper, LOS/PCN/SCN.2/1990/CRP.5 and Add.2.

35. In his report to the plenary of Special Commission 2, the Coordinator of the Group of Six reiterated the importance the Group of Six attached to the establishment of a nucleus Enterprise during the pre-operational stage. He pointed out that although consultations had taken place during the current session there had not been sufficient time to arrive at a compromise single option. He requested that the Special Commission give him and the Coordinator of the Contact Group of the Group of 77 on Special Commission 2 Matters additional time both intersessionally and at the tenth session to continue their dialogue.

36. The Coordinator of the Contact Group of the Group of 77 on Special Commission 2 Matters drew the attention of the Special Commission to an error in CRP.5/Add.2. In option 3 of the paper, he requested that the words "from the Authority" be deleted since they were not part of the Group of 77's position. On the consultations with the Coordinator of the Group of Six on the compromise text regarding a single option for the status and structure of the institutional arrangement during the transitional period, he reiterated the Group of 77's desire to arrive at such a compromise text. He noted, however, that while the Group of 77 had been making concessions, the Group of Six had not been forthcoming with any concessions of their own. He stated the Group of 77's position that a compromise text should remain faithful to the provisions of the Convention.

Assumptions

37. The Chairman's Advisory Group on Assumptions reviewed the current price movements in the four metals (nickel, copper, cobalt and manganese) and continued to study the paper, which compares some of the main parameters of the Australian study and the study done by French experts of IFREMER.

38. On the basis of information presented by the Australian expert and statistics compiled by the Secretariat, the Group observed that there had been minor fluctuations in nickel prices during 1990-1991. According to nickel

industry experts, new production capacities are now coming on stream and this may result in an oversupply of nickel. It is therefore anticipated that nickel prices will remain relatively low in 1991-1992. Copper prices were volatile during 1990-1991. Copper output is expected to increase but consumption is forecast to be lower this year compared to 1990, and this will exert downward pressure on copper prices. The manganese market remains tight and this may encourage new developments. The outlook for manganese is for a continuation of strong demand, and prices are also likely to remain strong. An increase in the demand for cobalt has been predicted for the 1990s. Although supply problems may occur, cobalt prices are forecast to remain firm.

39. The Group examined the paper submitted by the delegation of Australia (LOS/PCN/SCN.2/WP.10 and Add.1) which compares some of the main parameters of the Australian study on the economic viability of deep seabed mining and with those contained in the study done by French experts of IFREMER, under contract to the Commission of the European Communities (CEC). The Australian study was based on the premise that a deep seabed mining project would have an annual production rate of 3 million tons of dry nodules per year while the French study contemplates an annual production rate of 1.5 million tons per year. To enable a more accurate comparison, both sets of figures relating to discounted cash flow rate of return (DCFROR) were derived using the United States Bureau of Mines mine simulation (MINSIM) programme.

40. After an examination of the French study the Group concluded that a project with an annual production capacity of 1.5 million tons of dry nodules might be economically attractive. DCFROR obtained was estimated to be about 10 per cent after taxes and payment to the International Seabed Authority. The primary reason for the positive DCFROR is the higher recovery of manganese (in both qualitative and percentage terms) using pyrometallurgical processing. In the French study, manganese contributes substantially to the project profitability. Other factors used in the French study contribute to making it more favourable than the Australian study. For example, unlike the Australian study, the French study assumes that much of the pre-production activities such as research and development have already been carried out and that their costs are external to the mining project.

41. The members of the Group noted that in order to arrive at a new set of basic assumptions it was necessary to continue to examine new developments related to the technical and economic studies on the viability of deep seabed mining which might be made available to the Group by other pioneer investors.

42. The Group placed on record its appreciation to the experts from Australia and the European Economic Community for their continued assistance in the work of the Group.

Programme of work for the tenth session

43. The programme of work will be as follows:

(a) Harmonization and coordination of activities with respect to exploration and training prior to the entry into force of the Convention and in the period before seabed mining is about to begin;

(b) (i) Other matters arising from paragraph 12 of resolution II, including its subparagraphs (a) (i); (a) (iii); and (b), on which recommendations are needed to fulfil the mandate of Special Commission 2;

(ii) Any residual matters regarding the implementation of the Training Programme under paragraph 12 (a) (ii) of resolution II;

(c) Finalization of recommendations to the plenary of the Preparatory Commission on:

(i) Transitional arrangements for the Enterprise;

(ii) Annotations on the provisions of the Convention on the structure and organization of the Enterprise as contained in document LOS/PCN/SCN.2/L.8;

(d) Operational options:

(i) Joint ventures: annotations to WP.18 and Add.1;

(ii) Operational options seen within the context of the suggestions of the Chairman's Advisory Group on Assumptions.

44. The Special Commission having completed most of the tasks within its mandate is hoping to submit its final recommendations by the summer session of 1992.